The Role of the Money Supply in Business Cycles

By RICHARD G. DAVIS*

Most, if not quite all, economists are agreed that the behavior of the quantity of money makes a significant difference in the behavior of the economy—with "money" usually defined to include currency in circulation plus private demand deposits, but sometimes to include commercial bank time deposits as well.[1] Most economists, for example, setting out to forecast next year's gross national product under the assumption that the money supply would grow by 4 per cent, would probably want to revise their figures if they were to change this assumption to a 2 per cent decrease.

In the past five to ten years, however, there has come into increasing prominence a group of economists who would like to go considerably beyond the simple assertion that the behavior of money is a significant factor influencing the behavior of the economy. It is not easy to characterize with any precision the views of this group of economists. As is perhaps to be expected where complex issues are involved, their statements about the importance of monetary behavior in determining the course of business activity encompass a variety of individual positions, positions which may themselves be undergoing change. Moreover these positions are rarely stated in quantitative terms. More frequently, the importance of money as a determinant of business conditions will be characterized as "by far the major factor", "the most important factor", "a primary factor", and by similar qualitative phrases inescapably open to various interpretations.

Of course as one moves from the stronger phrases to the weaker, one comes closer and closer to the view that money is simply "a significant factor", at which point it becomes virtually impossible to distinguish their views from those of the great majority of professional opinions. In order to bring a few of the issues into sharper focus, this article will take a look at some evidence for the "money supply" view of business fluctuations in one of its more extreme forms. Without necessarily implying that all the following positions are held precisely as stated by any single economist, an extreme form of the money supply

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[1] More rarely, other types of liquid assets such as mutual savings bank deposits are also included in the definition of money.